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SUBJECT: SCENESETTER FOR A/S VALENZUELA'S VISIT TO PARAGUAY

CLASSIFIED BY: Perry Holloway, DCM; REASON: 1.4(B), (D)

SUMMARY

¶1. (C) Embassy Asuncion warmly welcomes WHA Assistant Secretary Arturo Valenzuela December 17-18. Your visit will serve as a boost to Paraguay's nascent democracy. An inexperienced President Fernando Lugo promised the electorate he would deliver change, but he has dashed expectations by failing to define or execute a national agenda. At this point, Lugo is his own worst enemy, mostly due to his weak leadership style. Because Lugo has not reached out to Congress or the political parties for support, his initial reform attempts have failed (or have never even gotten off the ground). Now, with declining popularity, growing concerns about the country's security situation and never-ending paternity scandals, the pressure is on Lugo to deliver concrete results. Your visit will reaffirm U.S. support for Paraguay's democratic institutions and economic growth, and can serve to encourage Paraguay to continue playing a helpful, neutral role in the region. The inclusion of Paraguay in your first trip to the region will give Paraguayans the validation they seek from the United States, and might keep them focused on solving the country's problems and developing democratic institutions. END SUMMARY.

LOCAL AND REGIONAL POLITICS

¶2. (C) Fernando Lugo's administration represents the first interruption in Colorado Party rule in 61 years. By voting overwhelmingly for change, the Paraguayan people gave the former Catholic bishop a mandate for political, economic, and social reform. That mandate, however, came with high expectations, and the widespread perception is that Lugo has failed to deliver. Lugo's biggest obstacles: virtually no political support in a divided Congress; endemic corruption throughout government (which Lugo inherited); a dysfunctional judicial system; and a weak inner circle of advisors who constantly jockey for influence and personal gain. Lugo has strained relations with both the Liberal Party (which is the largest party in his loose political coalition), as well as with his ambitious Liberal Party Vice President, Federico Franco. Lugo's goals of strengthening democratic institutions, promoting economic growth, and bringing about reform seem increasingly out of reach. As frustration grows, so do rumors that Lugo could be impeached (via constitutional means) before completing his term. So far, Lugo has weathered the storms he has faced (including several paternity scandals), and we do not believe

that impeachment is imminent for several reasons. Paraguay is a conservative country that resists change. Moreover, there is virtually a political deadlock over what would happen if Lugo were to be impeached and Vice Presidential elections were called, which lends itself to a certain political stability in which the status quo continues.

¶3. (C) Lugo is a leftist at heart, but a pragmatist of mind. He maintains close relations with Venezuela, Bolivia, and Ecuador, but also with the United States, Chile, Brazil, and Colombia. He said in late July that Paraguay's "first circle" is MERCOSUR, and that Paraguay does not seek to join the Bolivarian revolution, as evidenced by Paraguay not becoming a member of Bolivarian Alternative for the Americas (ALBA). Lugo is sensitive to interference in Paraguayan internal affairs, and resents Chavez' heavy hand in the region. However, Lugo certainly feels pressure (from within the region and from his own leftist advisors) not to get too cozy with the United States. Lugo met with President Bush in Washington in October 2008; he saw President Obama as well as a congressional delegation led by Congressman Engel at the Summit of the Americas in Trinidad and Tobago. To date, he has ensured that Paraguay plays a fairly neutral role in regional politics, shying away from either extreme.

¶4. (C) Regional tensions over the Colombia-U.S. Defense Cooperation Agreement (DCA) manifested in Paraguay's decision to decline the

DOD-sponsored New Horizons humanitarian exercise planned for 2010. (NOTE: However, at a September UNASUR meeting, Lugo defended Colombia's right to sign a base access agreement with the U.S. and said the DCA was a bilateral issue between Colombia and the U.S. END NOTE). The Paraguayan congressional response to the cancellation of New Horizons was overwhelmingly pro-U.S., and the Chamber of Deputies passed a resolution lamenting Lugo's decision. On Honduras, the Paraguayan government has officially refused to recognize election results and insists on Zelaya's restitution. (COMMENT: With a little bit of time, Paraguay, like Brazil, might back away from this position, but U.S. pressure regarding Honduras could easily be counterproductive. It will be difficult to construct good will with the Lugo government on this issue. END COMMENT).

THE ECONOMIC REALITY

¶5. (U) Paraguay's macroeconomic indicators show the country is weathering the financial crisis, and the economy is expected to grow by about four percent by the end of 2009. Exports markedly slowed in the first half of 2009 as a result of lower prices and weaker external demand for Paraguay's main export commodities (soy, grains, cattle), but recovered in the second half of the year. Unemployment is over 20 percent, and with a population growth rate above two percent per annum, the economy is not creating enough jobs to meet demand. Paraguay boasts vast hydroelectric resources, including the massive Itaipu hydroelectric dam built and operated jointly with Brazil, but fails to capitalize on those resources. The Lugo government purports to welcome foreign investment, but widespread corruption and a weak judicial system are deterrents. There is significant commercial activity involving the import of goods from Asia and to a lesser extent the United States for re-export to neighboring countries, mainly Brazil. The underground economy, which is not included in the national accounts, is probably twice the formal economy in size. Many private sector representatives worry that Lugo is undermining the business environment.

¶6. (U) Bilateral trade with the United States has increased over the last six years. The U.S. imported from Paraguay about USD 78.4 million in 2008, and exported over USD 1.6 billion, up from USD 1.2 million in 2007. U.S. Representative Engel introduced trade preference legislation (ATPA) in the U.S. Congress in April which would give Paraguay increased access to U.S. markets. Paraguay's lower house recently passed a resolution expressing its support for Engel's bill, and the private sector is lobbying heavily for trade preferences. More than a dozen U.S. multinational firms have subsidiaries in Paraguay, and some 75 U.S. businesses have agents or representatives in Paraguay. Cargill, ADM, Coca Cola, and Exxon Mobile are the largest U.S. companies operating in country. With around USD 400 million in private investment stock, the U.S. is Paraguay's largest foreign investor.

PUBLIC SECURITY ISSUES

¶7. (SBU) Security and social issues are top concerns of Lugo's constituents. Violent crime is increasing in urban and rural areas, and the public generally believes that Paraguayan security forces (particularly the corrupt police) do not meet their security needs. The "landless" farmer movement -- active for many years in Paraguay -- has organized protests and land invasions, calling for reform by illegally occupying large, privately-held ranches. However, the protests have been small in number, and have had a minimal impact at best.

¶8. (C) Kidnappers claiming to be members of the Paraguayan People's Army (EPP) seized wealthy rancher Fidel Zavala October 15

causing a national clamor. Individuals are hanging white ribbons on cars and houses demanding Zavala's release and highlighting national insecurity under President Lugo. Amidst security concerns and following several months of rumored changes, Lugo removed the Military Service Commanders and Commander of Military Forces (Chief of Defense) from their positions in early November. Many political analysts believe that Lugo's fate is tied to that of Zavala, and that Zavala's death could trigger impeachment proceedings against Lugo for not managing security issues well.

¶9. (SBU) The Tri-Border Area (TBA) of Paraguay, Argentina and Brazil is a hub for transnational criminal activity including drug trafficking, trafficking in persons (TIP), arms trafficking, intellectual piracy, and money laundering, including terrorist financing. Paraguay is a major transshipment point for cocaine from Bolivia to Brazil; it is the second largest marijuana producer in the region. Paraguay remains a regional haven for money laundering. Paraguayan authorities often experience difficulties enforcing the law because of hostile geography, corruption, chronic understaffing, and the political and judicial power some drug traffickers wield. Paraguay took a giant step forward on money laundering, intellectual property violations, and trafficking in persons by passing a tougher penal code that went into effect in July.

¶10. (SBU) The DEA works closely with Paraguay's underfunded Anti-Narcotics Secretariat (SENAD) on counternarcotics issues, with support from State's International Narcotics and Law Enforcement (INL) program. DEA efforts focus on SENAD's Sensitive Investigative Unit (SIU), and intensified this year via an increased presence in country after Bolivia expelled the DEA. In addition to counternarcotics, the INL program (USD 253,000 in FY2009; USD 500,000 requested for FY2010) also supports other

Paraguayan institutions in combating narcotics trafficking, money laundering, IPR violations, and trafficking in persons.

OTHER U.S. ASSISTANCE TO PARAGUAY

¶11. (SBU) U.S. assistance in Paraguay is consistent with many of Lugo's goals. The centerpiece of our assistance is Phase Two of the Millennium Challenge Corporation's Threshold Program (Umbral in Spanish), which the Paraguayan Congress approved July 31. The Threshold Program, worth USD 30 million, focuses on anti-corruption. USAID/Paraguay's FY09 budget is USD 17.15 million and focuses on Economic Growth; Health Care; Sustainable Management of Natural Resources and Protected Areas; and Democratic Strengthening. A USD 6.6 million 1207 program will begin early next year, focusing on municipal government, economic development, and security issues in eastern Paraguay. USG support for the Paraguay Military Forces is limited but robust. One highlight is the U.S. Armed Forces' USD 4.1 million donation of Global Peace Operations Initiative (GPOI) funds and technical assistance to Paraguay's United Nations Global Peace Keeping Operations Program (UNPKO). Another highlight is US Special Forces training for Paraguay's Joint Special Forces Battalion (BCFE), which 1208 monies equipped at a cost of well over USD 5.7 million.

COMMENT

¶12. (C) While Lugo's impeachment is not (now) imminent, his popularity has dropped to 25%. With growing concerns about the country's security situation and never-ending paternity scandals, the pressure is on Lugo to deliver concrete results. Our programs are designed to help him do just that, should Lugo provide the necessary political will to carry them through. In this increasingly sensitive environment, our approach must be measured. Political actors across the spectrum look to us for cues, and our

influence is much greater than our footprint here. We have been careful to express public support for Paraguay's democratic institutions-not for Lugo personally-and to make sure Lugo understands the benefits of a close relationship with the United States-without allowing him to use Embassy support as a political life preserver when it serves him. With all sides eager for Embassy signals about "whither Lugo," we must be careful to steer clear of domestic politics or we will influence them to our detriment. Your visit will reaffirm U.S. support for Paraguay's democratic institutions and economic growth, and can serve to encourage Paraguay to continue playing a helpful, neutral role in the region. Under Lugo, Paraguay has demonstrated that it is not a would-be Venezuela or Bolivia. Likewise, it is not the next Honduras, as we do not think a coup is a realistic possibility in this conservative country, given its weak but institutional military and aversion to that part of its recent history. But Paraguay does merit our attention, and the significance of your visit to Asuncion on your first trip to the region will not be missed. END COMMENT.

AYALDE